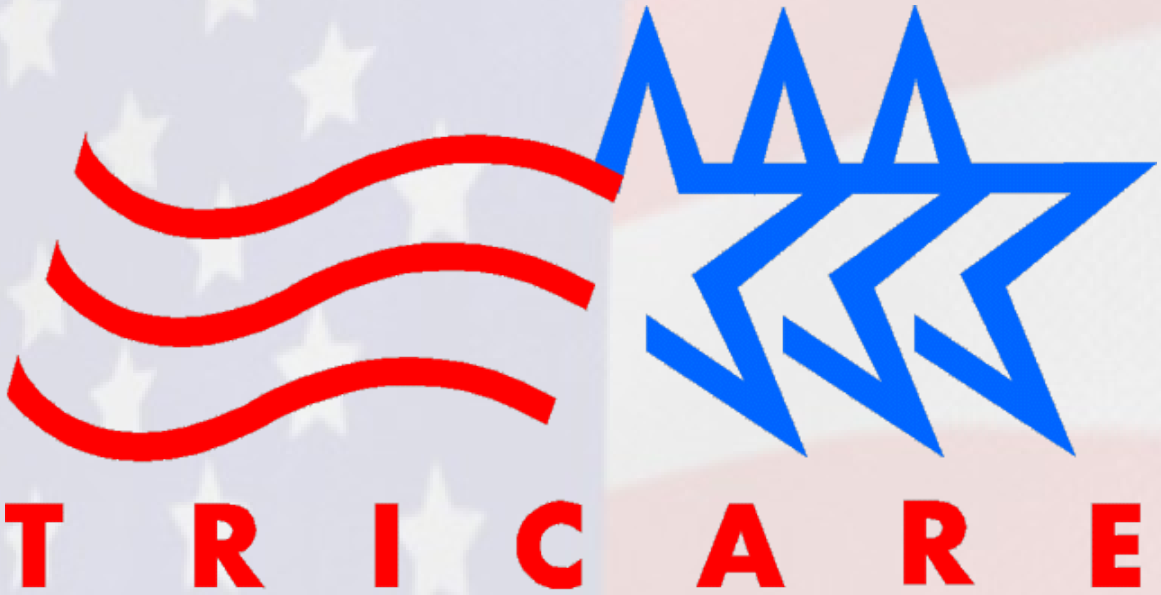
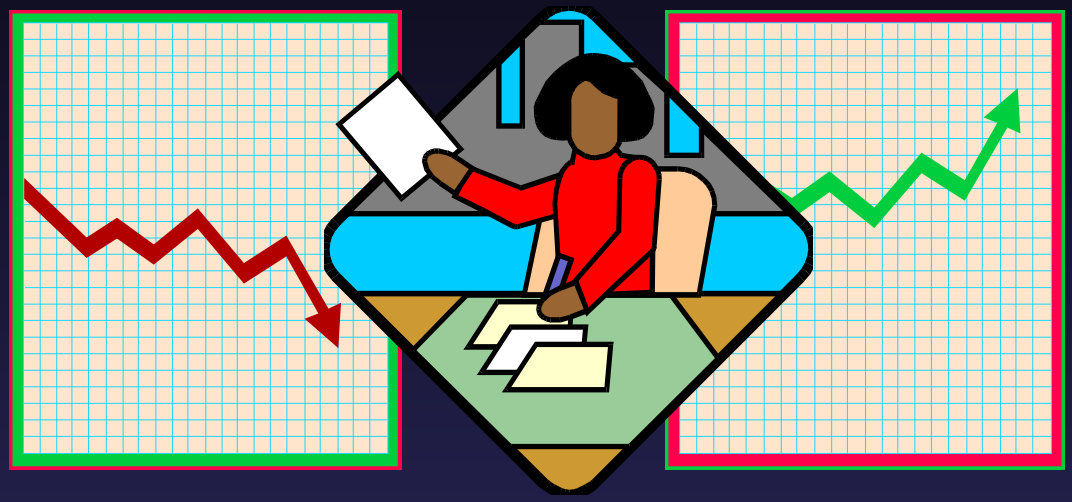


2000

“Focus on Performance”

Financial Decision Making



Major Julie Hall and Major Kevin Broussard TMA, Resource Management, Financial Analysis and Integration Office

Overview

- Key Financial Planning Concepts

-Maj Broussard

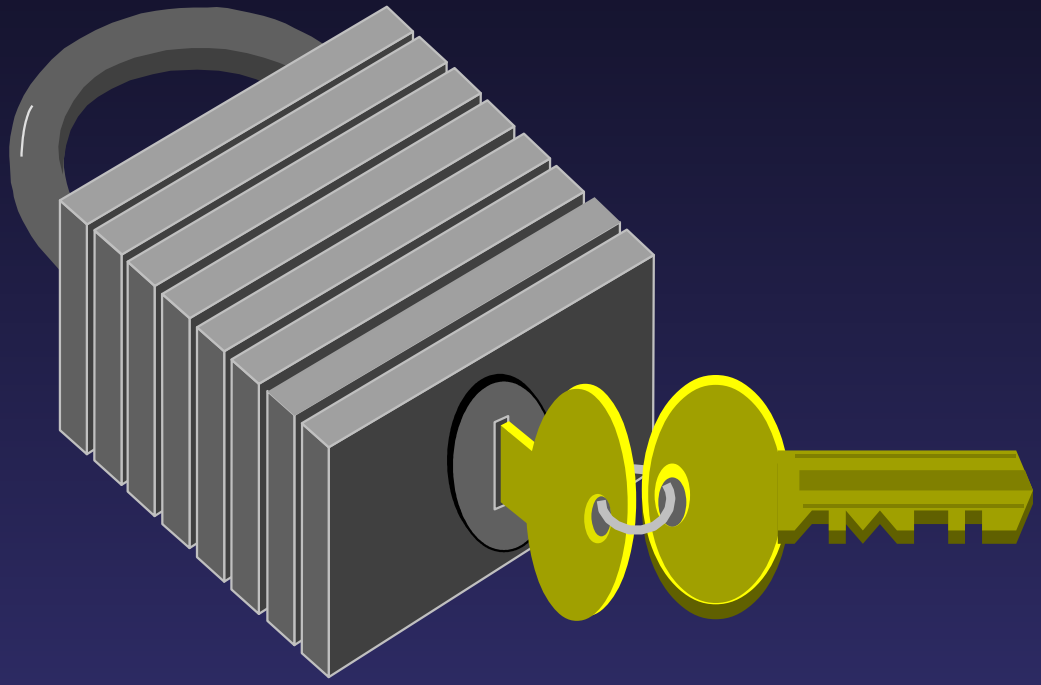
  - Inflation, Return on Investment,Time Value of Money, Present Value and Net Present Value

- Financial Performance Indicators

-Maj Hall

  - Wall Street Report
  - EBC Management Tool

Key Concepts for Financial Planning



Inflation! Inflation! Inflation!

- Inflation is an increase in the general price level.
  - It is an erosion in the value of money--a loss of purchasing power.
- Pay increases are inflation.
- Pharmaceuticals, medical equipment, and contracts are other major inflation components of your budget.

Inflation Continued

- Include inflation estimates in any forecasting and budgeting beyond 1 year.
- Sources for inflation factors:
  - DoD inflation factors: **http://www.dtic.mil/comptroller/FY2000budget/GREEN2000.pdf**

    and then go to chapter 5, “Pay Raises, Pay Increases and Treatment of Inflation.”
  - Bureau of Labor Statistics: http://stats.bls.gov and then access the “Data” page.

Return on Investment

- Return on investment (ROI) is a measure of the excess value and is expressed as a percentage.
- Formula: Net savings ÷ investment cost
- Example for recapturing civilian workload:

(Cost of civilian care - cost of providing that care in house - investment cost) ÷ investment cost

ROI Continued

- ROI is useful for evaluation of performance.
- Can also be used as the first step in making an investment decision between alternatives.
  - If one has a negative ROI, you may want to exclude this alternative.
- Limitation of ROI is that it does not take into consideration the time value of money.

Time Value Of Money

- Would you rather have $1,000 today or $1,000 one year from now?
- A dollar today is worth more than a dollar tomorrow-you can invest the money and earn a return.
- A resource gain or outlay in the future is less valuable in the future than the same sum today.
  - Not only because of inflation, but because of the lost interest earned if the money is invested later or the additional interest paid the longer the money is borrowed.

Time Value Of Money Continued

- For the government, the less money we spend over a period of time, the less interest we must pay for borrowing the money through such mechanisms as issuing U.S. Treasury securities.
- The basis for making the determination as to whether the money should be invested or borrowed is discounting.

Present Value

- Discounting or present value is used to determine the value today of resource flows over the life of a program or project or, in other words, present value of the resource gains or outlays.
- For example, if you want $10,000 in 5 years and can invest the money at 10% return compounded per year, how much do you need to invest now to reach $10,000 in 5 years?

Present Value Continued

- Answer: $6,210, the present value of $10,000 at 10% compounded for 5 years.
- Excel and other computer software programs make present value calculations easy.
- Same theory applies to loans and Treasury securities.
  - Debtors loan to the government the present value of the sum of money they want in the future.
  - Investors in Treasury securities pay the present value of the security.

Present Value Continued

- Therefore, the longer lenders forego their money, the more the expect to earn, and thus a higher interest rate.

What does this have to do with me in the Military Health Service?

Net Present Value

- You can use present value to determine which of several alternatives you should pursue.
- Example: Should we purchase a laser or send patients to civilian facilities for laser treatments?
- By taking the present value of the cost of purchasing a laser and deducting it from the present value of the savings from not sending patients to civilian facilities, you have the net present value of this alternative.

Net Present Value Continued

- Net present value is the present value of the savings over the life of the project less the initial investment and present value of the costs.
  - Do not include in the costs any costs that you would incur with the other alternatives--e.g. if all alternatives require you to pay for a technician, do not include the technician's salary.
- The project with the highest net present value would then be, from the financial perspective, the best alternative.

Net Present Value and ROI Example

- **In-House**

  Assumes 8-year useful life and zero residual value

  Initial investment: $200K

  Recurring maintenance and supply costs: $125K

  Total Costs: $325K

  Present Value: $296K

- **Civilian Care**

  Total Recurring costs for 8 years: $425K

  Present Value: $344K

- **Net present value**

  Savings from in-house: $296K - $344K = ($48K)

- **Return on Investment**

  ($425K-$325K)/$200K = 50%

Net Present Value Continued

- When making the decision which alternative to choose, you must consider other factors such as patient welfare and customer service.

Resources for Additional Information

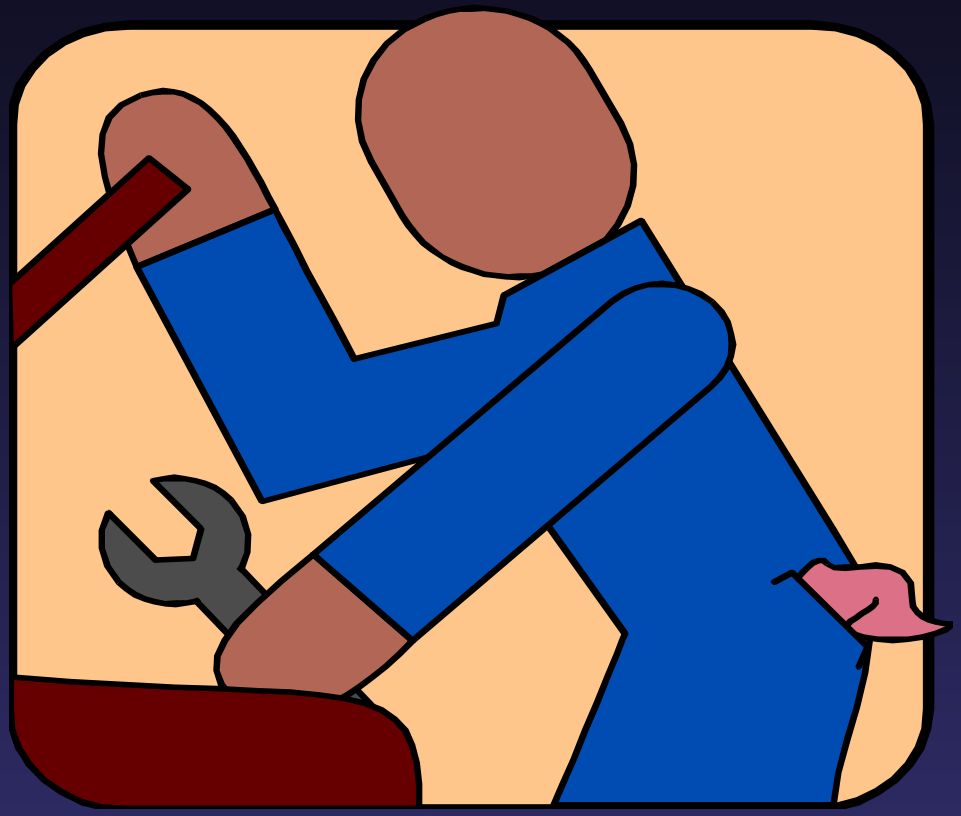
- DoD Instruction 7041.3, Economic Analysis for Decision Making--available at: http://www.saffm.hq.af.mil/FMC/7041-3.html
- Army's "Economic Analysis Manual" available at http://www.asafm.army.mil/ and click on "Publications."
- Air Force: http://www.saffm.hq.af.mil/ and click on "FMC" and then "Economic Analysis"

Resources for Additional Information Continued

- Navy: Check with the Naval Center for Cost Analysis at http://www.ncca.navy.mil

- Any finance text book

Tools That Indicate Performance



Wall Street Report

Requested by Dr. Sears

- Contains financial data for Senior TMA Executive Leadership
- One stop shopping for TMA financial data
- Synopsis of Army, Navy, Air Force, TMA financial data
  - Makes comparisons
  - Reviews Workload
  - Reviews Population
  - Reviews commodities spending on a timely basis
  - Observes Profit/Loss of MCO Performance

EBC Input to Wall Street Report

- Shows Profit/Loss (or Operating Margin)
- Page 1, MTF Scorecard, shows projected revenues (also called earnings) for PEC 87700 (MCO equivalent) in capitation category 3, NOT your entire financial program
- Page 2, Resourcing Scorecard, shows actual DFAS obligations (also called expenses), with adjustments for errors

Financial Decision Making and EBC

- Tool to determine how efficient MTFs are at delivering peace-time health care
- How well an MTF manages dollars within a capitated budget
- Provides information on current healthcare delivery patterns; to help managers optimize spending

EBC Model Key Metrics for MCO Performance

- Capitation Rates-Determine Earnings
  - FY00 based on FY99 data
  - EBC Resourcing Pool-Cat 3, MOST-PEC 87700
  - Enrollment-Equivalent Lives
- Accounting for Care Purchased/Provided
  - Costs and Prices for Medical Services: Inpatient, Ambulatory, Ancillaries, NMOP and MCSC Clai

Key Metrics

- Profit/Loss (Operating Margin) = Revenues - Expenses
  - If revenues exceed expenses, you have earned a profit (positive operating margin)
  - If expenses exceed revenues, you have incurred a loss (negative operating margin)

Earnings Scorecard Data
Page 1

EBC MTF Scorecard
Earnings (Page 1)

	Target	Actual
External Customers	110,000	97,000
Medicare Allocation	75,000	75,000
Prime Cap Earnings	400,000	430,000
Purchased Care	-100,000	-90,000
Total (Earnings)	485,000	512,000

Resourcing Scorecard Data
Page 2

EBC Resourcing Scorecard Expenses (Page 2)

Direct O & M Funds	$215,000*
Net Military Personnel	205,000
TPC / OHI Reimbursement	22,000
Resource Sharing	60,000
Total Resourcing	$502,000

This is a notional example.

Income Statement
Program Element 0807700 - Category III
(adjusted)

Page 1
Earnings
Expenses

Capitated Earnings

+ Medicare
+ Provided Care (to others @ your MTF)
- Purchased Care (for your enrollees outside MTF)

Net Earnings

Page 2
Resourcing

O&M
Third Party
MILPERS
Net Resources Used

Net Contribution

Net Earnings - Net Resources Used
=Net Contribution

% + or -

Percent Profit/Loss

EBC Earnings (PG 1) **$512,000**

Resources Used (PG 2) **$502,000**

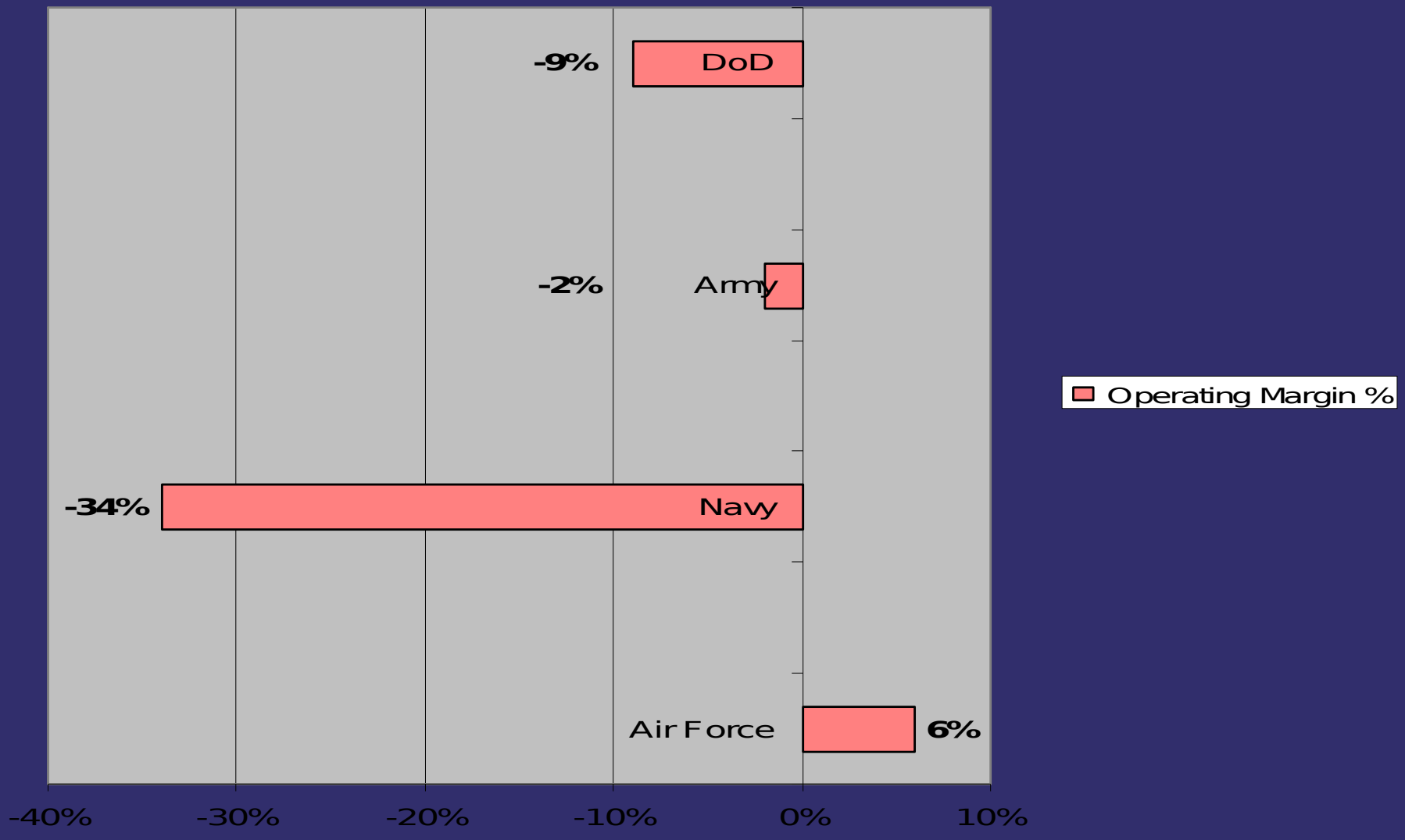
Difference (net contribution) **$ 10,000**

Operating Margin* **2% (.0195)**

***Operating Margin = Earnings from pg1 - Resources Used from page 2**
Actual Earnings from Page 1

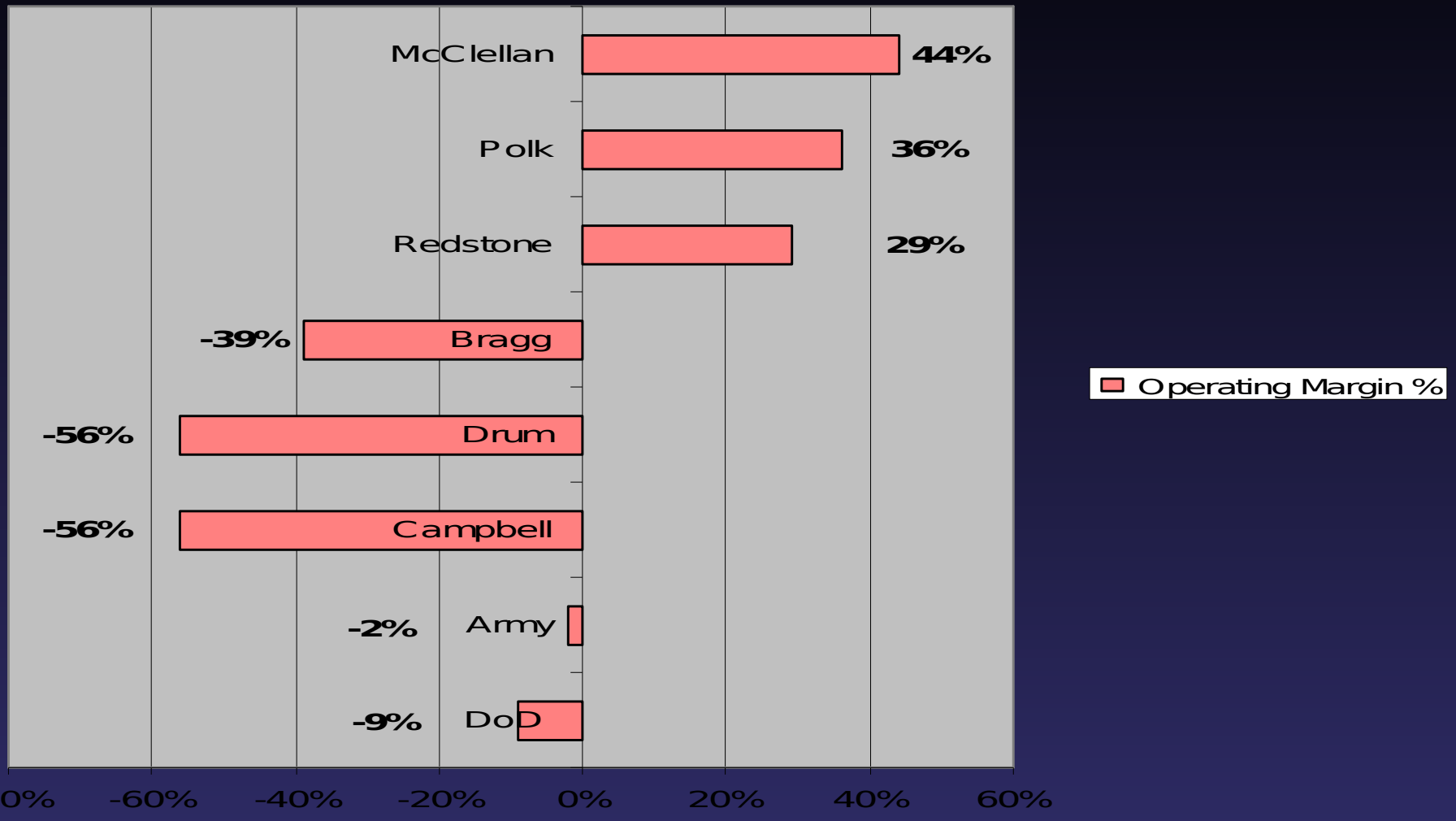
This is a notional example.

Services & DoD (FYTD - Aug 99)
Net Operating Margin Percentage



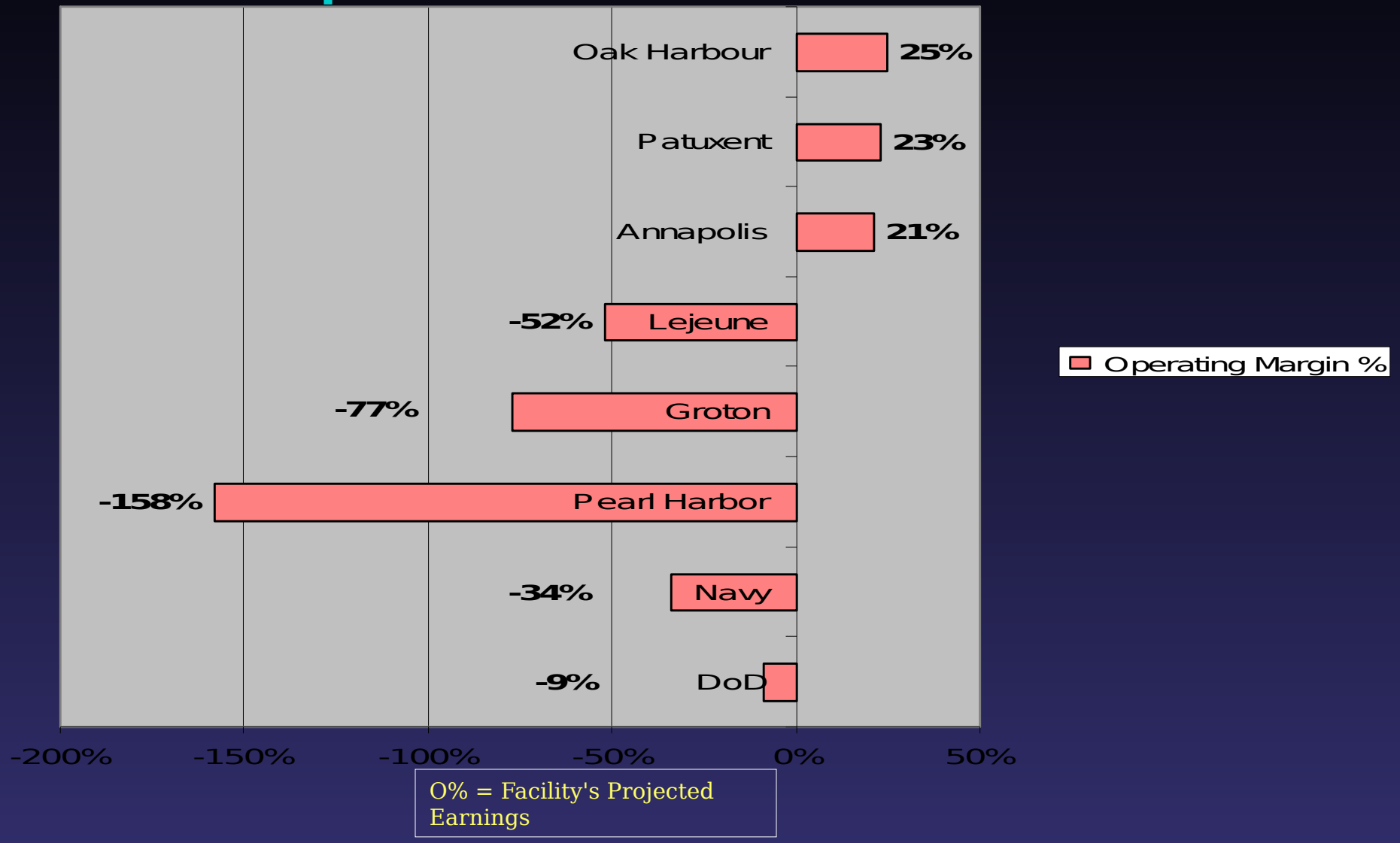
* Net Earnings : Resources

Army (FYTD - Aug 99)
Net Operating Margin Percentage
Top & Bottom Three Performers

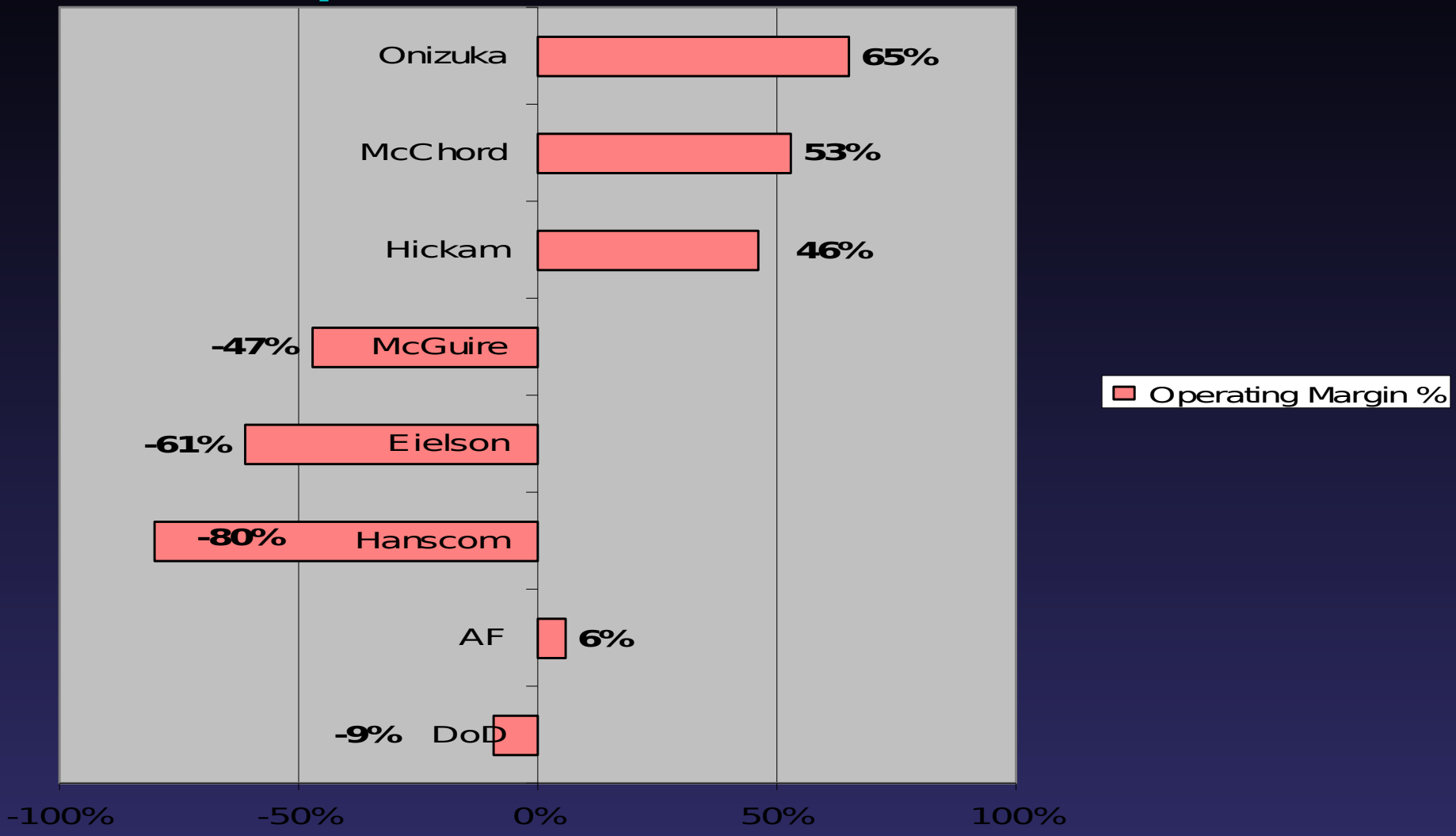


O% = Facility's Projected Earnings

Navy (FYTD - Aug 99)
Net Operating Margin Percentage
Top & Bottom Three Performers



Air Force (FYTD - Aug 99)
Net Operating Margin Percentage
Top & Bottom Three Performers



0% = Facility's Projected Earnings

QUESTIONS

DEPARTMENT OF DEFENSE

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